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SUBJECT: ZAPATERO ANNOUNCES MEASURES TO ADDRESS ECONOMIC
SITUATION, REACTION SKEPTICAL

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Classified By: DCM Hugo Llorens for E.O. 12958 reasons 1.4(d),(e)

¶1. (C) Summary and Comment: On June 23, President Zapatero acknowledged the economy's rapid deceleration, said growth in 2008 would be below 2 percent but would start to recover in the second half of 2009, and announced 21 reforms. The measures include spending cuts that are being perceived as an attempt to show that the GOS is sharing the public's pain but are not likely to have a significant impact. Most of the other measures are structural reforms that, while they may have positive effects in the medium term, are not likely to address the immediate slowdown. Because of a perception that Zapatero has downplayed the severity of the economic situation, initial public reaction was skeptical. As the GOS cannot do much in the short term about high fuel or food prices or the housing slowdown and is locked in the monetary straightjacket of the ECB, nothing it does is likely to satisfy the public. The next year or two could be unpleasant for the government, as well as for Spaniards. End Summary and Comment.

¶2. (U) In his annual state of the economy report on June 23, President Zapatero acknowledged that the Spanish economy was indeed suffering a rapid de-acceleration, with growth now expected to be less than 2 percent for 2008 as a whole, though it would start to recover in the second half of 2009. Despite this admission, Zapatero assured the public that Spain was in a strong position to confront the situation and would overcome this slowdown by the second half of 2009. Zapatero refrained from using the word "crisis," a term which has been used frequently by the media and by opposition Partido Popular leaders to describe the current economic situation and criticize the government.

¶3. (U) During the speech, Zapatero presented a package of 21 short-, mid-, and long-term measures to improve Spain's competitiveness and address the economic situation. They included measures to confront the deceleration, austerity measures, and structural reforms. A list follows:

Measures to Address the Deceleration

- ¶1. More credit lines to small businesses and government-protected housing;
- ¶2. Encouraging renovation of homes and hotels;
- ¶3. Establishment of a new framework for home renovation;
- ¶4. Credit and subsidies for consumers who purchase fuel-efficient vehicles;

Austerity Measures

- ¶5. Reduce the number of new government jobs in 2009 from 35,000 to 10,000;
- ¶6. Reduce current spending by at least 20 million euros immediately;
- ¶7. Freeze salaries of high-level officials;

Structural Reforms

- ¶8. Increase investment in infrastructure and transportation;
- ¶9. Implement a plan for professional training and development;
- ¶10. Increase the amount of cargo transported by rail;
- ¶11. Allowing Autonomous Communities and private capital to participate in airport management;
- ¶12. Port law to reduce trade restrictions and facilitate trade;
- ¶13. Energy efficiency and renewable energy law;
- ¶14. Agreement with France to double the electricity interconnections;
- ¶15. Increase access to wide-band telecommunications services;
- ¶16. Improve the quality and reliability of wide-band services;
- ¶17. Law to improve competition in the service sector;
- ¶18. New framework for professional services;
- ¶19. Reduction of business registration and notarial fees;
- ¶20. Facilitate the creation of businesses within 24 hours;
- ¶21. Reduce administrative burdens for businesses.

¶4. (U) These 21 measures come on the heels of the June 13 approval by the Council of Ministers of a draft law that would accelerate value-added tax returns and eliminate wealth taxes in 2009, with a combined expansionary impact of 7.8 billion euros in 2009. This was the government's second major stimulus effort since Zapatero's reelection in April. The first was the April 18 package (reftel) that included the 400 euro refunds promised in the campaign and is expected to

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have a combined expansionary impact of 10 billion euros in 2008 and 8 billion in 2009. Assuming the legislature cooperates as expected, the total stimulus from both sets of measures will be about 1 percent of GDP in 2008 and 1.6 percent in 2009.

¶5. (C) Comment: Although the structural reforms could eventually increase productivity, many of the measures Zapatero announced will have little impact in the short term, several are far from being implemented, and many were already planned. In terms of macroeconomic impact, it does not look very coherent for the government to announce spending cuts just 10 days after approving an expansionary stimulus program. However, the spending cuts are expected to save only 250 million euros in 2008 and 2009 combined, a contraction dwarfed by the almost 26 billion euro expansionary impact of the two stimulus packages. Second Vice President and Finance Minister Solbes (who is reported to have not been involved in preparation of the package) has characterized the June 23 austerity measures as psychological. Initial public reactions suggested that they are seen as politically rather than economically motivated, to give an example of the government sharing in the hard times and taking action. Even the structural reforms do not address labor laws, which many economists consider an important target for reform.

¶6. (C) Comment continued: It is not clear that the GOS has policy options that would enable it to satisfy public wishes. The budget surplus of previous years that it had said gave it maneuvering room is gone as a result of lower tax receipts. Inflation is stubbornly high, and unemployment is expected to pass 10 percent and continue rising into next year. There will be no expansionary monetary policy in line with the GOS, fiscal stimulus as long as the European Central Bank keeps interest rates high to fight inflation. The average Spaniard is experiencing the effects of higher food and fuel prices every day and is well aware of the collapse in residential construction. Regular news of real or threatened strikes by various interest groups to protest

rising prices or other economic concerns heightens the awareness of the economic difficulties faced around the country.

17. (C) Comment continued: If the media and the public believed Zapatero's statement that the economy will start to recover in the second half of next year, the mood might be different. However, at the moment his and the GOS' credibility on economic issues is low. Over the last several months, he and his economic team have regularly revised downward their forecasts, as previous projections -- whether for how low growth would drop, when it would rebound, how rapidly unemployment would increase, or when inflation would start to decline -- proved too optimistic. There is a widespread perception that Zapatero and the GOS intentionally downplayed the severity of the situation during the campaign for the April 9 elections.

18. (C) Comment continued: Perhaps because he does not want to damage already shaky consumer confidence, he and other officials have refused to use the word "crisis." While the current situation may not be a crisis in the strictest sense of the word, it is certainly a difficult period, and Zapatero's statements have given many the impression that he is either intentionally downplaying the problem or does not understand its severity. This speech appears to have been an attempt to show that he understood the severity of the situation and was taking action. However, since the GOS cannot do much in the short term about high fuel or food prices or the housing slowdown and does not have monetary levers to stimulate the economy, it is not likely to satisfy the public. It could be an unpleasant next year or two for the government, as well as for Spaniards.

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